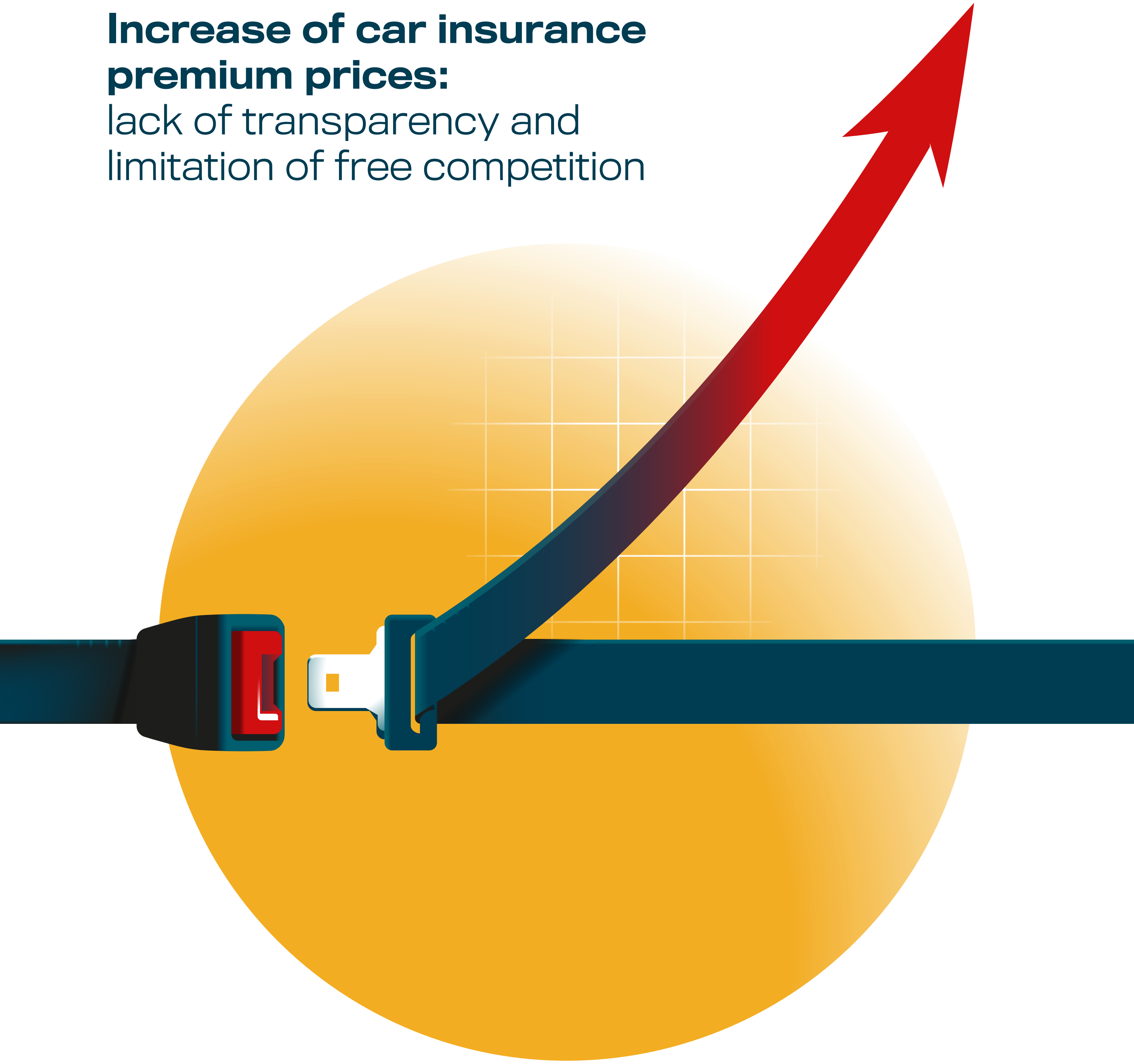
Increase of car insurance premium prices:
lack of transparency and limitation of free competition



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This analysis was originally written in Albanian

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Executive Summary

On October 31, 2019, the Executive Board of the Central Bank of Kosovo (CBK), consisting of the Governor and two Deputy Governors,[1] took a split decision to increase the tariffs for compulsory motor vehicle insurance (category 1) by 26%. This tariff review was in line with the recommendation of the International Monetary Fund (IMF), however the IMF did not suggest a specific rate of increase, but rather only ascertains that tariff review failed to take account market developments, such as inflation in medical spending, behavioral change in drivers due to technology, or changes to risk profiles as a result of court rulings.[2] In its decision, the Board failed to take any of these factors into account, and increased the tariffs only following the inflation rate over the period 2002-2018, though the IMF mentions that tariffs were reviewed in 2011.[3] The accumulated inflation was deducted the cost of five percent of corporate income tax which will no longer be paid in gross premiums by insurance companies, but rather on taxable income.[4] This decision is contrary to the professional opinion of the Kosovo Competition Authority (KCA) and the decision with the actuarial report have not been published on the CBK website. Based on the opinion of the Kosovo Competition Authority and the report of the International Monetary Fund on the actuarial capacities, GAP Institute raises doubts over the legitimacy of this decision. Therefore, the objective of this brief analysis is to shed light to the context and make an assessment of the decision-making process of the CBK executive board. Given the weight of this decision, GAP Institute recommends the Assembly of Kosovo to commission an international professional company to assist in producing a professional and transparent review of compulsory vehicle insurance tariffs.

Insurance sector and CBK oversight capacity

The insurance sector in Kosovo is small compared to financial system assets in Kosovo. Written premiums per capita are lower than in the countries of the region, while compared to European countries, Kosovo represents one of the smallest insurance markets.[5] However, this sector faces a number of issues. For instance, in 2019, three of the 14 insurance companies were undercapitalized. On the other hand, a large number of vehicles in Kosovo remain uninsured which, in turn, reduces profits for these companies.[6] Considering that motor liability premiums constitute the main (over half of) premium income for non-life insurance companies in Kosovo, the aforementioned decision to increase vehicle insurance fees will significantly increase insurance company revenues on one hand, but also the cost of car registration for the owners of about 300 thousand cars on the other.[7] The decision will particularly affect the budget of rural households which spend about six percent of their budget on transport.[8]

1 CBK, CBK Executive Board, Source: https://bqk-kos.org/?id=6
2 IMF, Financial Sector Stability Review, October 2019
3 CBK, CBK reviews insurance tariffs for passenger vehicle categories, Source: https://bqk-kos.org/index.php?id=104&l=1692
4 Law No. 05/L-029, on Corporate Income Tax, Source: https://gzk.rks-gov.net/ActDetail.aspx?ActID=11016
5 IMF, Republic of Kosovo: Financial System Stability Assessment, April 2013
6 European Commission, Kosovo* 2019 Report, Source: https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-kosovo-report.pdf
7 KAS, Transport and Telecommunications Statistics Q4 2019, Source: https://ask.rks-gov.net/media/5282/transporti-tm4-2019-shqip.pdf
8

In addition to the tariff increase, insurance companies will pay about four million Euro less in corporate income tax as they will no longer pay tax on gross premiums but rather on taxable income.[9]

In addition to the financial problems of insurance companies, international reports have cited oversight of the insurance sector in Kosovo as poor.[10] CBK oversight officer of insurance companies are not able to understand how insurance companies interact with policyholders. Insurance companies have restrictions on investment, marketing expenses or other expenses, but these restrictions are complied with by only a number of companies. The inability to compete with prices and the lack of restriction enforcement have made the spending ratio in Kosovo to be around 48%, while the average elsewhere is from 25% to 40%. However, the CBK cannot provide an explanation of these unusual trends compared to other countries.[11] In 2013, the IMF recommended the CBK to hire two licensed actuaries. The CBK did not license one until April 2017, or about four years after the IMF issued its recommendation.[12] Actuaries are the most important technical people, in terms of tariff proposals. In the current tariff review, the CBK actuary, along with a private company actuary, drafted the report proposing an increase of the aforementioned tariffs. On the other hand, given the period from the certification until the drafting of the report, the CBK actuary will have had only two years of experience as a licensed actuary. Considering the limited experience, the CBK can gain access to additional actuarial expertise through the engagement of international professional companies.[13]

Shortcomings regarding the decision to increase tariffs for premiums

From a legal point of view, the decision to uniformly raise insurance tariffs contradicts the CBK objectives which require it to operate on the principle of a market economy, and also conflicts with the principles of the Law on Protection of Competition.[14] RreAbout one month prior to CBK making a decision to increase tariffs, the Kosovo Competition Authority (KCA) responded to the CBK's request for professional opinion on the matter. According to the KCA decision, given that companies have different sales strategies, different customer profiles, and different cost structures, the interaction of companies should be avoided and that uniform pricing is contrary to the principles of open competition.[15] Law on the Protection of Competition provides for punitive of up to 30% of revenues for the relevant market in which the company has violated the law. However, since the decision is made by a public institution, the KCA has no powers to sanction companies.[16] The CBK decision also appears to be in contradiction with the regulation adopted by the CBK itself regarding the setting of insurance rates.[17]

9 Law No. 05/L-029, on Corporate Income Tax,
Source: https://gzk.rks-gov.net/ActDetail.aspx?ActID=11016

10 European Commission, Kosovo* 2018 Report,
Source: https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-kosovo-report.pdf

11 IMF, Financial Sector Stability Review, October 2019

12 CBK, FSA certifies new actuaries, Source: https://bqk-kos.org/index.php?id=104&l=1425

13 IMF, Financial Sector Stability Review, October 2019

14 Law No. 03/L-209 on the Central Bank of the Republic of Kosovo, Article 7.4,
Source: https://gzk.rks-gov.net/ActDetail.aspx?ActID=2696

15 KCA, Decision, September 12, 2019,
Source: https://ak.rks-gov.net/assets/cms/uploads/files/Mendimi%20Profesional%20drejtuar%20BQK.pdf

16 Law on Protection of Competition, article 59.

17 CBK, Regulation on the Structure of Premiums for Compulsory Motor Liability Insurance,
Source: https://bqk-kos.org/repository/docs/korniza_ligjore/shqip/Rregullore%20per%20strukturen%20e%20primit%20per%20sigurime.pdf

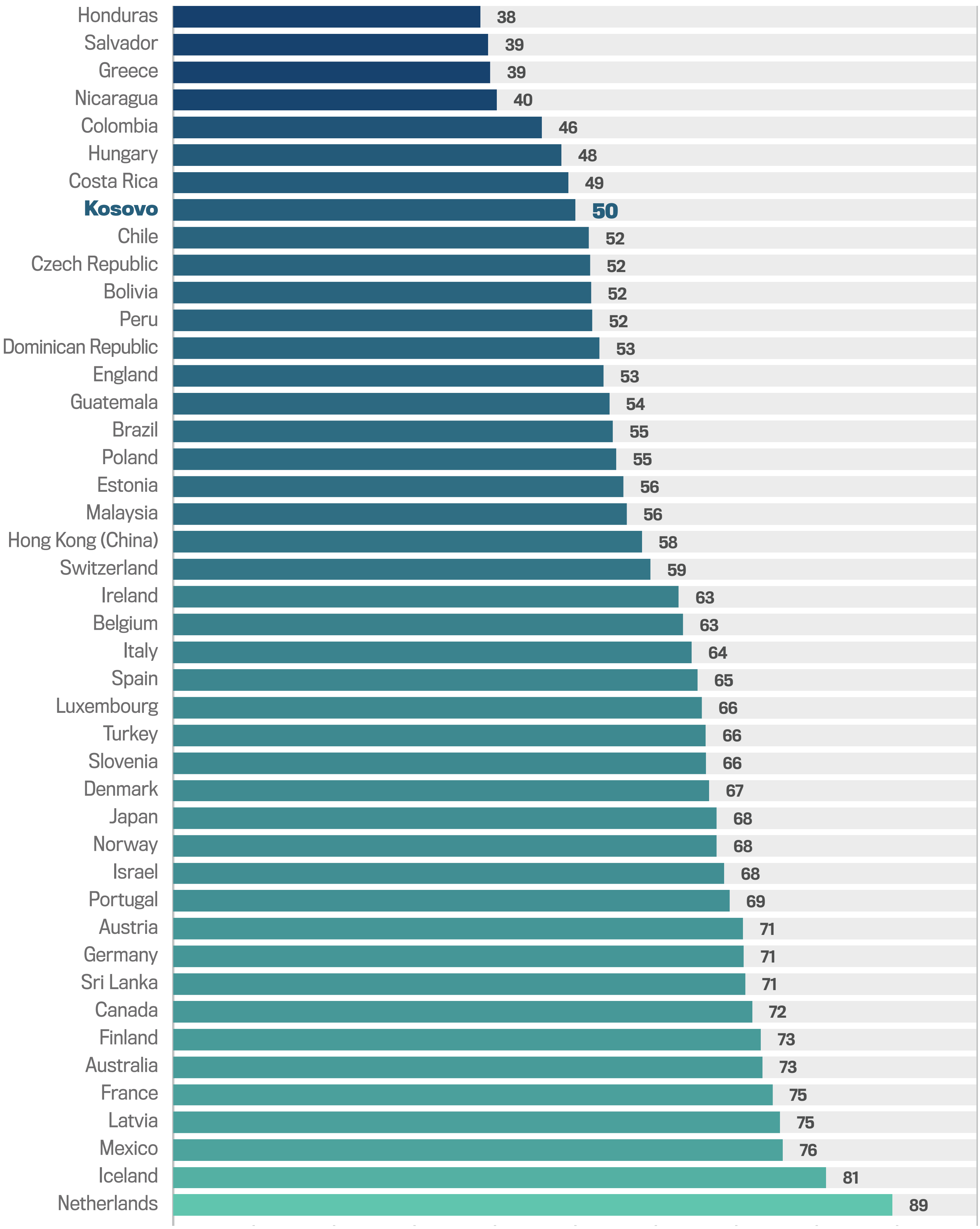
In all cases where actuary's tables on tariff setting are mentioned, the regulation reference to the company, in singular, never as an industry-level product.[18]

In addition to adhering to the principles of competition, the CBK Law also gives this institution the task of informing the Government of Kosovo, the Assembly of Kosovo and the public about its policies, duties and operations.[19] However, CBK decided to keep this decision confidential, calling on internal regulations, although the aforementioned decision directly affects a large number of citizens, increasing the cost of living. On December 10, 2019, GAP Institute requested from CBK access to the decision of the executive board and the "Actuarial Study" which the CBK used as reference when deciding to increase the prices of vehicle insurance. However, contrary to its obligations, CBK has not made these documents public, demanding that we meet with its officials, rather than making them public. Following our public reaction, CBK provided these documents to the GAP Institute, but prohibited their publication, calling on internal regulations. According to CBK, based on the internal rule on secrecy, examination reports are documents classified as "confidential" and information on the situation in the financial sector containing individual data and information on financial institutions is classified as "secret". However, after gaining access these documents, we observed that neither document contains individual information on insurance companies. CBK releases similar information at sector level on a monthly basis.[20]

According to the CBK regulation on setting premiums, some of the factors considered in setting tariffs are: risk profile, damages incurred, general and product inflation, and the compensation fund coefficient. The loss ratio is a measure that compares, in principle, the claims paid against the premium or fee income. Based on 2018 data, if we compare the ratio of losses in Kosovo with that in other countries of the world, we find that Kosovo non-life insurance companies (which includes car insurance) are ranked under the average of other countries' losses. Hence, such losses are related to the factors that influence the setting of risk premium or tariff. According to the IMF, such a low loss ratio may be the result of underestimation of claims for damages, especially of those in litigation, due to a lack of reserves. [21] On the other hand, in the absence of opportunities and constraints for financial investment, such a low ratio of damages does not imply a higher return on equity or profitability compared to other countries.

18 See Article 5
19 Law No. 03/L-209 on the Central Bank of the Republic of Kosovo, Article 8, paragraph 1.8,
20 See Time Series for Insurance Companies in this link: https://bqk-kos.org/?id=55
21 The calculation for Kosovo may move for 1 to 2 percentage points due to the lack of an accurate figure on changes in demand reserves

Figure 1. Loss ratio



Source: GAP Institute calculation for Kosovo data and OECD Global Insurance Statistics data

In 2018, the average of non-life insurance claims in the world was about 60%, while in Kosovo its around 50%. Similar claims ratio figures are also applicable to compulsory TPL and TPL plus insurance. However, according to the CBK actuarial report, the claim ratio for a specific category, that of passenger vehicles, in 2018 was expected to be around 77.54%. One option was to target a claims ratio of 50% by increasing the tariff by 36.56 percent, whereas in its decision, CBK increased the tariff by 26% and the claims ratio is expected to be around 54%.

As mentioned above, the CBK regulation and the IMF recommendation provide for a number of factors to be considered when setting the risk premium. However, CBK made the decision based solely on one of these factors - that of inflation. Another issue related to this increase is the estimated inflation period, as CBK has required the insurance companies to adjust their tariffs in line with the accumulated inflation rate for 2002-2018. However, according to the IMF, based on World Bank technical assistance, the premiums have not been adjusted to market developments since 2011, not 2001, as the CBK stated. Also, according to the actuarial report, the CBK conducted an analysis of the TPL risk premium in 2012, which found that the premium level represented "high security". Taking this into account, according to the CBK 2012 findings, the inflation rate, at least until 2012, has not posed a problem for the sector's stability. Thus, there is confusion as to when tariffs were last reviewed.

Conclusion and recommendations

Motor third party liability insurance is the main source of income for insurance companies in Kosovo. The decision to increase the tariffs for compulsory motor insurance will directly increase the costs of Kosovo citizens for transportation, and will increase revenues for these companies. Although this decision has a major economic impact, both for citizens and the insurance industry, the decision was taken in conditions where the CBK lacks the professional capacity, transparency, and in violation of the Law on Protection of Competition, and the Law on CBK. Although the CBK itself initiated the request to KCA for an opinion regarding the compatibility of the decision with the principles of open competition, the CBK's decision to uniformly increase tariffs is in contradiction with the professional opinion of the KCA. Another issue affecting public confidence in this decision is the low transparency of the CBK during and after decision-making. The lack of confidence in the insurance sector and the increase in tariffs could lead to further increases in the number of unregistered cars which, in turn, will decrease the profitability of the sector.

In order to increase public confidence in this decision, in line with IMF recommendations, GAP Institute recommends that the Assembly of Kosovo hire an international professional company to conduct a transparent assessment of the rationale for the increase of insurance rates. Such company would address the problem of the lack of professional capacities in CBK, and would allow for an assessment of the tariffs in accordance with the applicable laws, making an assessment of the risk premium separately for each company.

As the decision to increase the tariffs, the actuarial report and the IMF report of 2019 do not contain information on individual insurance companies, the CBK should make these documents public to encourage an evidence-based debate. In addition, the CBK should increase its internal oversight capacities and, as required by the regulation, conduct regular reviews of insurance rates.

Lastly, this is yet another case where citizens may potentially have been harmed by high prices due to lack of competition. However, due to its limitation in powers, KCA is unable to intervene. Taking this into account, policymakers and other civil society actors should organize debates on how these situations can be avoided and what should be done with decision-makers in public institutions when they take decisions in violation of applicable laws.

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